



# **IDAHO**

## **GUIDE TO COMBINED REPORTING**

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## Introduction

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This guide is an overview of how Idaho taxable income is determined for a unitary business operating through more than one corporation and in more than one taxing jurisdiction.

More detailed information can be found in the Idaho Corporation Income Tax Return and Instructions, the Idaho Code, the Idaho Income Tax Administrative Rules, court decisions, and other sources of authority.

### Combined Report

A combined report is simply the computational method used to determine the amount of income of a unitary business that is attributable to the operations within a particular state. It is often referred to as combined reporting or the combined reporting method. In this guide we will use the term combined reporting method to help emphasize that this is a computational method, not a return.

The use of the combined reporting method is restricted to C corporations. An S corporation cannot use the combined reporting method.

To understand how the combined reporting method works, it is necessary to understand the concepts of apportionment and what constitutes a unitary business.

### Apportionment

Computing the portion of a business's income that relates to its activities in Idaho is done through apportionment. Income is considered the result of three kinds of economic activity: use of capital, use of labor, and use of market. These three activities are measured by a corporation's property, payroll and sales. An Idaho factor is computed for each activity. The factors are used to compute the Idaho apportionment factor, which is applied to the income of the unitary business to determine the portion of income earned in Idaho.

### Unitary Business

A business may be conducted through divisions of a single corporation, or through commonly-controlled corporations. A business is unitary if the operations conducted by one division or corporation benefit, or are integrated with, depend on, or contribute to operations conducted by another division or commonly controlled corporation.

If separate divisions or separate corporations are interdependent or of mutual benefit, so as to form one integral business rather than several businesses, they are unitary. The incomes of the entities composing the unitary business are added together to arrive at combined income.

The theory underlying the unitary business principle was developed during the 1870's, in the field of property taxation, as a way that local governments could tax railroads operating within their jurisdictions. The courts recognized that the value of the railroad system was more than the cost of rails and ties located within a particular state. The system connected two distant points and represented an integrated economic unit, of which each state could claim its appropriate share. All of the railroad's property was valued as a single unit and a portion of the unit's value was assigned to each state by a mathematical formula. The application of the unitary approach evolved when states started to impose a tax measured by the income of corporations.

## History

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The following examples and statements are taken from court cases that have helped develop the combined reporting method.

In 1920 the United States (U.S.) Supreme Court approved the use of a formula to apportion the income of a single corporation among several states in the case of *Underwood Typewriter Co. v. State Tax Commission*, 254 U.S. 113. In this case substantially all manufacturing was in one state while most of the sales occurred in other states. The court ruled that the state was justified in relying on formula apportionment rather than dealing with the impossible task of allocating the profits earned by the processes conducted within its borders.

In 1924 the U.S. Supreme Court first sanctioned the use of the unitary business principle to worldwide activities in *Bass, Ratcliff & Gretton Ltd v. State Tax Commission*, 266 U.S. 271. Bass, operating through a single corporation, brewed ale in England and sold it in England, New York and elsewhere. The court held that New York could apply a formula to worldwide profits even though the corporation's separate records reflected a loss in New York.

The use of formula apportionment is based on the assumption that all the activities of the corporation constitute a single business or unit. In *Butler Bros. v. McColgan*, 17 Cal. 2d 664, 111 Pac. 2d 334, aff'd 315 U.S. 501 (1942) the court stated " If there is any evidence to sustain a finding that the operations of appellant in California ... contributed to the net income derived from its entire operations in the United States, then the entire business of appellant is so clearly unitary as to require a fair system of apportionment by the formula method in order to prevent overtaxation to the corporation or undertaxation by the state."

In *Butler Brothers*, the court held that a business is unitary if there is (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use of its centralized executive force and general system of operation.

In *Edison California Stores v. McColgan*, 30 Cal. 2d. 472, 183 Pac. 2d 16 (1947) the court held that if the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary. The court ratified the use of the combined report concept by extending the logic that required divisions to account as a single business to a commonly controlled multi-corporate group.

In *Edison*, the taxpayer operated a chain of separately incorporated shoe stores nationwide. One subsidiary operated stores in California. The court found that the factors that led to the conclusion that *Butler Bros.* was engaged in a unitary business were also present in the *Edison* case. Therefore, the fact that the business was conducted through separate corporations rather than controlled branches was immaterial.

In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933 (1983), the U. S. Supreme Court explicitly approved the application of the unitary business principle to multiple corporations operating worldwide. Container was a vertically integrated corporation that manufactured custom-ordered paperboard packaging. The court said that the prerequisite to a constitutionally acceptable finding of a unitary business is a flow of value. Flow of value results from all or some combination of functional integration, centralization of management, and economies of scale.

The *Container* decision also approved the appropriateness of formula apportionment stating "Not only has the three factor formula met our approval, but it has become something of a benchmark against which other apportionment formulas are judged."

In *Albertson's, Inc. v. Department of Revenue*, 106 Idaho 810, 683 P.2d 846 (1984), the Idaho Supreme Court unanimously approved the use of the combined reporting method applying logic similar to that applied in *Container*. The main issue was whether Texas-Albertson's, Inc. was unitary with Albertson's, Inc. Texas-Albertson's Inc. was formed to hold a 50% interest in the Skaggs-Albertson's partnership joint venture. As examples of unities the court cited the following:

1. Albertson's provided Texas-Albertson's directors and principal officers from the ranks of Albertson's personnel.
2. Albertson's employees provided services like bookkeeping, tax return preparation, payment of officers and directors, and preparation of corporate meeting documents.
3. Albertson's furnished all of Texas-Albertson's initial operating capital with no repayment schedule.

The U.S. Supreme Court in *Allied-Signal Inc. v. Director Division of Taxation*, 504 U.S. 768 (1992) stated that "In the course of our decision in *Container Corp.*, we reaffirmed that the constitutional test focuses on functional integration, centralization of management, and economies of scale. ... We also reiterated that a unitary business may exist without a flow of goods between the parent and subsidiary, if instead there is a flow of value between the entities."

In *Barclays Bank PLC v. Franchise Tax Board of California*, 512 U.S. 298 (1994) the U.S. Supreme Court referred to the "unitary business principle" as settled jurisprudence. Barclays Bank PLC is a United Kingdom

corporation in the Barclays Group, a multinational banking enterprise. In *Barclay's*, the Court reiterated the following: "As explained in *Container Corp.*, unitary taxation 'rejects geographical or transactional accounting,' which is 'subject to manipulation' and does not fully capture 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise.' ... The 'unitary business/formula apportionment' method 'calculates the local tax base by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction.'"

## **Combined Reporting Contrasted With Consolidated Returns**

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A combined report is often confused with a consolidated return. They are not the same thing. When filing a federal consolidated return, a single income tax liability is determined for the affiliated group of corporations included in the consolidated return. A consolidated return requires a common parent.

Idaho law does not provide for the filing of a consolidated return. Each corporation having sufficient contact with Idaho has its own filing responsibility and tax liability. Each corporation in a unitary group with a filing requirement in Idaho, must determine its Idaho income tax liability by using the combined reporting method. Corporations can be unitary without a common parent (e.g., brother-sister).

The combined report is a computational method used to determine the amount of business income to be reported to Idaho by each member of a unitary group. It does not refer to whether the unitary group files a single return or several returns.

The example included in this guide illustrates how to compute the tax liability for each of three corporations that have a filing responsibility in Idaho. These three corporations belong to a unitary business consisting of four corporations. An Idaho income tax liability is computed for each of the three corporations using the combined reporting method. In other words, we attribute to Idaho the portion of the combined income of the unitary group that relates to the activities of each of the three corporations that have contact with Idaho.

In our example the unitary group files using the combined reporting method. Each corporation included in the combined group must compute its own apportionment factors. It does this by including its total Idaho property, sales, or payroll in the numerators and using the property, sales, or payroll of all the corporations included in the combined report in the denominators.

## **Group Return**

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We've just discussed the fact that Idaho law does not provide for the filing of consolidated returns. Each member of a unitary group that has some definite link or some minimum connection with Idaho computes its own tax liability using the combined reporting method. Each corporation has its own tax attributes such as apportionment factors, nonbusiness income or loss, net operating losses, taxable income, tax, and credits.

For convenience, Idaho allows the filing of a group return. A group return is the sole return filed by a unitary group. A group return does not ignore the corporate identities of the individual corporations. Each corporation is considered a taxpayer even though it is part of a unitary group and regardless of whether a group return is filed or each corporation files its own income tax return. On a group return, the apportionment factor attributes for each corporation are totaled and reported on a single Schedule 42, which is part of the Idaho Corporation Income Tax Return, Form 41. If a group return is filed, spreadsheets showing the computation of the tax attributes for each corporation must be attached.

If filing an Idaho group return, the taxpayer must include a copy(s) of the federal return(s) and spreadsheets showing the following for each corporation in the unitary group:

- Income, intercompany eliminations, and combined income.
- State adjustments to federal taxable income.
- Idaho and combined property, payroll, and sales amounts and the resulting apportionment factor.

- The computation of unitary business income apportioned to Idaho, nonbusiness income or loss allocated to Idaho, Idaho net operating loss carryforward, Idaho taxable income, Idaho income tax, application of income tax credits, permanent building tax, and total tax due.

## **Business Income Versus Nonbusiness Income**

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The United States Constitution requires a relationship between an activity and a state before the state can tax the activity. If the taxable activity is part of a unitary business, the combined income of the unitary business is subject to apportionment.

Apportionment means prorating business income or loss among the various states where the business is conducted. Apportionable income includes investment income that serves an operational function. For example, apportionable income may include interest, dividends, and gains on investments of working capital, as well as investment income on sinking funds, and income from other investments necessary to satisfy creditors or future needs of the business. Apportionable income is also referred to as business income.

To determine if income is operationally related to the unitary business, and therefore apportionable rather than allocable, Idaho looks to two tests. Meeting either test results in the income being apportionable business income.

The first test, generally referred to as the "transactional test," provides that if income arises from a transaction or activity in the regular course of the taxpayer's business, the income is business income. For example, interest and gains derived from investments of working capital are transactions in the regular course of business.

The second test, generally referred to as the "functional test," provides that if the acquisition, management, or disposition of property constitutes "integral parts" of a taxpayer's regular trade or business operations, the income is business income. For example, a manufacturing company acquires, uses, and disposes of tangible as well as intangible assets as a part of its regular operations. Although the sale of a manufacturing facility may occur infrequently, this type of transaction does occur in the normal functioning of a manufacturing business.

The U.S. Supreme Court in *Allied-Signal Inc. v. Director Division of Taxation*, 504 U.S. 768 (1992) recognizes the possibility that a corporation may have investment income that does not serve an operational function but rather an investment function. Investment income from a discrete activity that is not operationally related to the unitary business of the taxpayer is allocable income, rather than apportionable income. Allocable income is also referred to as nonbusiness income.

Nonbusiness income is allocated to the state of the corporation's commercial domicile or the state where the nonbusiness income was earned. Commercial domicile is the principal place from which the trade or business of the taxpayer is directed or managed.

## **Worldwide Combined Reporting**

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If a taxpayer is part of a unitary group, the combined report must include the income or loss and apportionment factor attributes of all unitary corporations with more than 50% common ownership. This includes corporations incorporated outside the United States.

Corporations incorporated in the United States or included in a consolidated federal corporation income tax return must include federal taxable income in the combined report. Foreign corporations can choose one of two amounts to include in apportionable income.

Under the first option they can include the financial net income before income taxes shown on consolidated financial statements filed with the U.S. Securities and Exchange Commission (SEC). If the unitary group is not required to file with the SEC, they can use the profit or loss statement prepared for reporting to shareholders and subject to review by an independent auditor.

The second option they can choose is to restate the financial net income of each foreign corporation to a federal income tax basis. If this option is chosen, all book to tax adjustments are required for each foreign corporation. The adjustments must be applied consistently in each year that the worldwide method applies. In addition, the adjustments are subject to the recordkeeping requirements of the Internal Revenue Code (IRC) and Treasury Regulations for domestic corporations.

## **Water's Edge Election**

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A taxpayer may make a water's edge election. A taxpayer who makes a water's edge election must take into account the federal taxable income of corporations filing a federal income tax return or included in a federal consolidated return, except for corporations filing elections under IRC Section 936 (possession corporation). However, the income of corporations filing elections under IRC Section 936 will be deemed dividends received from payors incorporated outside the 50 states and District of Columbia. A portion of the dividends received from foreign corporations or deemed received from foreign corporations is excluded from apportionable income.

The water's edge election must be made on the return as originally filed. The election cannot be made on an amended return. If a taxpayer wishes to change from the water's edge method to the worldwide filing method, permission must be requested from the Idaho State Tax Commission.

A domestic disclosure spreadsheet must be filed no later than six months after filing the original return. The unitary business may elect to forego the filing of the spreadsheet. If the spreadsheet is not filed, the 85% exclusion of foreign dividends and the deemed dividends from Section 936 corporations must be reduced to 80%. The election to forego filing the spreadsheet is a yearly decision made by checking the "Yes" box on the face of the Form 41.

The Idaho Water's Edge Election and Consent Form, as well as the domestic disclosure spreadsheet and instructions, will be provided upon request. The form must be completed fully and accurately or the election may be ineffective.

## **Net Operating Losses**

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Each corporation included in the combined report that is required to file an Idaho income tax return must separately compute its Idaho net operating loss (NOL). Each corporation's NOL carryback and carryover is applied to its share of the combined income apportioned to Idaho for each taxable year.

## **Partnership Interests**

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If a corporation is a member of a partnership or joint venture, the corporate partner includes its share of partnership income in apportionable income. Additionally, the corporate partner takes into account its share of partnership property, payroll and sales, after intercompany eliminations, including these numbers in the numerators and denominators of the corporation's factors.

The corporation is not required to hold more than a 50% interest in the partnership or joint venture to include its share of partnership income and factor attributes in the combined report. A partnership interest is included in the combined report if the operation of a partnership or joint venture is an extension of the unitary business of the partner or venture member.

## **Different Accounting Periods**

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To apply the combined reporting method, it is necessary that the income of all corporations in a combined group be determined on the basis of the same accounting period. If a parent-subsidiary relationship exists, the income of all corporations generally is determined based on the parent's taxable year. If there is no common parent corporation, as in the case of brother/sister corporations, the income of the related corporations generally is determined based on the taxable year of the corporation required to file an Idaho return and

expected to have the largest amount of Idaho income.

In converting the income of a member of the related group to conform to the taxable year of the parent or other related corporation, income generally is determined based on the number of months falling within the applicable taxable year. For example, if a parent corporation operates on a calendar year basis and a subsidiary includible in a combined report operates on an April 30 fiscal year, it is necessary to assign 8/12 of the subsidiary's income of the current fiscal year and 4/12 of the unitary income of the preceding fiscal year to include a full twelve-months' income in the combined report. If this procedure results in using the income of a corporation whose fiscal year has not yet closed, it may be necessary to make an estimate based on available information and amend the return at a later date.

After the combined income of the unitary group of corporations is determined based on a common taxable year, the next step is to apportion the combined income within and without Idaho by applying the apportionment formula. The factors of the formula are computed based on the same common taxable year as used to compute the unitary income.

## Example

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This example illustrates the concepts covered in this guide. We use a unitary group that includes the parent corporation and three subsidiaries.

Three of the four unitary corporations in our example have sufficient connection with Idaho requiring them to file Idaho income tax returns. The attached schedules identify the tax attributes of each corporation with a filing requirement. A group return is filed, so the schedules in our example include totals that will appear on the group return.

### Combined Federal Taxable Income

Of the four corporations, the following three corporations filed a federal consolidated income tax return, Form 1120: Parent Corp., Subsidiary 1 (Sub 1), and Subsidiary 2 (Sub 2). Both Sub 1 and Sub 2 are 100% owned by Parent Corp.

Subsidiary 3 (Sub 3) is not included in the federal consolidated return but files a separate return. Parent Corp. owns 70% of the stock of Sub 3 which is less than the 80% ownership requirement for inclusion in a federal consolidated return but satisfies the more than 50% ownership required for inclusion in the combined report.

Schedule 1300, page 12, shows the federal taxable income of the four corporations.

### Defining the Scope of the Unitary Business and Combined Apportionable Income

More than 50% of the voting stock of all four corporations is owned directly or indirectly by a common owner. Common ownership is required for inclusion in a combined report.

Some of the factors indicating that the four corporations comprise a unitary business are:

- Parent Corp., Sub 1, Sub 2, and Sub 3 have some of the same directors and officers.
- Capital budgets for all four corporations are reviewed by Parent Corp.
- There are \$2,000,000 in intercompany sales.
- Parent Corp. purchases insurance for all of the corporations and provides legal counsel. Insurance and legal services provided by Parent Corp. were billed to its subsidiaries with the intercompany charges totaling \$300,000 and reported by Parent Corp. as "other income."
- Large loans for all four corporations are arranged by Parent Corp.

These facts indicate that Parent Corp. and its three subsidiaries are unitary. The combined reporting method is therefore required.



The income of the unitary business is the total of each corporation's income or loss net of intercompany eliminations. See Schedules 1200 and 1300 for the computation of apportionable income. The total net income of the four corporations is the "combined income" that is apportioned between Idaho and other taxing jurisdictions.

### **Addition of Tax-Exempt Interest**

The Idaho Code requires the addition of interest and dividends received or accrued during the taxable year from securities issued by states other than Idaho and its political subdivisions, which interest is exempt from federal income tax under the IRC. However, any expenses not allowed under IRC Sections 265 and 291 that are related to the production of this income reduce the amount of interest and dividends added back.

On Schedule 1200 we see an addition for "Interest and dividends exempt under IRC" for \$20,000. Parent Corp. received a total of \$21,000 of interest income from municipal obligations issued in states other than Idaho. This interest income is tax exempt under the IRC. Parent Corp. on its federal return reduced its interest expense by \$1,000 pursuant to IRC Section 265. Consequently, the net amount of tax-exempt interest income added back is \$20,000.

### **Interest Expense Offset for Tax-Exempt Interest Income**

A deduction is not allowed for interest expense on indebtedness related to obligations that earn interest income exempt from Idaho tax. The portion of interest expense attributable to tax-exempt obligations is computed using a ratio.

On Schedule 1200 we see a deduction for "Tax-Exempt Interest on U.S. Obligations" of \$75,000 "Less interest expense offset" of \$(2,684) which was computed on Schedule 1500, page 13.

### **Capital Gains**

In our example, Parent Corp. has a \$350,000 capital gain on the sale of stock representing a minority interest in a corporation not included in the unitary group. The stock investment was not a temporary investment of working capital of the unitary business. Parent Corp. bought the stock when it thought the shares were undervalued. The stock was not purchased to further a business relationship with either a supplier or customer of any of the four unitary corporations, to obtain technical know how or marketing information, or for any other operational reasons. The investment was passive rather than operational. As a result, the gain on the sale of this stock is excluded from the apportionable tax base of the unitary group, and neither the sales price nor the gain from the sale of the stock is included in the sales factor computation.

The \$350,000 nonbusiness gain on the sale of the stock was included in the \$800,000 of capital gain net income reported as part of federal taxable income, as shown on Schedule 1300. Consequently, a nonbusiness deduction of \$350,000 is a state adjustment on Schedule 1200. Because the nonbusiness gain is income from the sale of an intangible it is allocated to the state of the corporation's commercial domicile. If nonbusiness income is attributable to property other than an intangible, then the nonbusiness income is allocated to the jurisdiction where the property is located. Since nonbusiness income is not included in apportionable income, it is not included in the sales factor computation.

The remaining \$450,000 of capital gain net income was net gain on the sale of securities that were included in an investment portfolio as part of the corporation's treasury function. A treasury function is a pooling and management of liquid assets for the purpose of satisfying the cash flow needs of the business, such as providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, and providing for business acquisitions. If the taxpayer holds liquid assets in connection with a treasury function, then upon disposal of such assets the overall net gain (rather than the associated gross receipts) is included in the sales factor. In our example, the \$450,000 net gain is the result of the company's treasury transactions (transactional test) in the regular course of the taxpayer's business. As apportionable business income, the \$450,000 net gain is included in the sales factor computation as part of "Other gross receipts" under Everywhere Sales on Schedule 1800, page 15.

On Schedule 1300, Sub 1 reported a \$275,000 gain on the sale of an idle production facility. This gain is apportionable business income because the plant at one time functioned as an operational asset (functional test). The sales factor includes receipts from the sale of the plant rather than the net gain. In this case the plant sold for \$1,500,000, which is the amount included in the sales factor, rather than the resulting \$275,000 net gain. The \$1,500,000 is included in the sales factor denominator (see "Other gross receipts" under Everywhere Sales on Schedule 1800), but not in the Idaho numerator because the plant was located outside of Idaho.

### **Expense Offset for Nonbusiness Income**

All deductions and interest expense directly related to the production of nonbusiness income must be allocated together with the income produced. Any allowable deduction that is applicable both to business and nonbusiness income of the taxpayer is prorated to those classes of income in determining income subject to tax.

In the example, the taxpayer allocated to its state of commercial domicile, \$350,000 of gain on the sale of stock. The federal return included deductions related to this sale for commissions paid, fees paid to legal counsel to prepare and review documents, compensation paid to corporate executives for the time spent on the sale, and sundry other expenses totaling \$40,000. The \$40,000 of expenses are reflected as a nonbusiness expense offset to the \$350,000 deduction for allocated nonbusiness gain (see Schedule 1200).

In the example, the corporation sold stock that generated \$350,000 of nonbusiness gain. Prior to the sale of the stock, Parent Corp. received a \$25,000 dividend, which it also treated as nonbusiness income. Schedule 1200 of the example shows a deduction from apportionable income for the \$25,000 of nonbusiness dividends. Administrative expenses of \$5,000 related to the allocated dividend are shown as an offset on Schedule 1200.

### **Corporations Subject to Idaho's Jurisdiction to Tax**

Both Parent Corp. and Sub 1 lease property and transact business in Idaho. Consequently, both are subject to Idaho's income tax.

Sub 2 does not do business in Idaho, but it filed with the Idaho Secretary of State's office and received a certificate of authority to transact business in Idaho. Although Sub 2 has zero property, payroll, and sales in Idaho, its authorization to do business in Idaho establishes a filing requirement. It is subject to the \$20 minimum corporate income tax and the \$10 permanent building fund excise tax.

Sub 3 makes some sales into Idaho. The orders are taken by phone at a sales office outside of Idaho and goods are shipped into Idaho by common carrier. Sub 3 has no other contact with Idaho such as sales of services, owned or rented property in the state, nor has it filed with the Idaho Secretary of State. Mere solicitation of sales in Idaho is insufficient to give Sub 3 nexus in Idaho under Public Law 86-272. Consequently, Sub 3 is not required to file an income tax return. Sub 3's sales are not included in the sales factor numerator, and Sub 3 does not owe the \$20 minimum income tax, nor the \$10 permanent building fund tax.

### **Company Apportionment Factors and Tax Liability**

The amount of combined income apportioned to operations of the unitary business in Idaho is computed by a three-factor formula. See Schedule 1100, page 10, and supporting Schedules 1700, 1800, and 1900.

Both Parent Corp. and Sub 1 transact business in Idaho, resulting in an apportionment factor for each of these corporations.

Sub 2 is only a name holder in Idaho. Consequently, its apportionment factor is zero.

Although part of the unitary business, Sub 3 does not transact business and is not a name holder in Idaho. Consequently, its apportionment factor is zero.

In computing the factors, intercompany transactions are eliminated. Intercompany transactions eliminated from the sales factor include sales, interest, rents, royalties, and management fees. Intercompany transactions eliminated from the property factor include items such as intercompany profits in beginning and ending inventories and intercompany rents.

The sales factor is double weighted for all corporations except for electrical and telephone utilities. A unitary group that includes corporations that qualify and corporations that do not qualify as electrical or telephone corporations, should attach a schedule to the Form 41 that shows the computation of each corporation's Idaho apportionment factor. One Schedule 42 should be filed for the group by carrying forward the total amounts from the by-company schedule and entering them on the appropriate lines of the Schedule 42. Double weighting of the sales factor is shown on Schedule 1800 of the example.

### **Throwback Sales**

Sub 1 makes sales into Montana, filling orders from inventory located in Idaho. The sales activities in Montana by Sub 1 employees fall within the protection of P.L. 86-272, and therefore Sub 1 is not subject to income tax in Montana. Consequently, the \$200,000 in sales of merchandise into Montana are included in the Idaho sales numerator as throwback sales because the merchandise was shipped from a warehouse in Idaho. See Schedule 1800.

Sales to the U.S. Government are included in the sales factor numerator of the state from which they were shipped.

### **Unitary Sharing of Investment Tax Credit**

Each corporation included in a combined report is required to compute Idaho credits and applicable limitations. Limitations based on tax are computed using the individual corporation's own tax liability, not the total tax of the unitary group. With the exception of the Idaho investment tax credit, credit earned by one corporation included in a unitary group cannot be used by another member of the unitary group.

Idaho allows an investment tax credit (ITC) equal to 3% of the amount of qualifying property. Earned credit can be used to offset 50% of the income tax liability of the corporation that earned the credit. If the earned credit exceeds 50% of the corporation's tax liability, the amount not used may be shared with other members of the unitary group that have not met the 50% limitation. ITC not used or shared may be carried forward up to 14 years. The unitary sharing of ITC is the one exception to the principle of separate tax attributes for members of a combined group.

In our example, we see on Schedule 1700 that Sub 1 increased the amount of real and tangible personal property in Idaho by \$800,000. Of this amount, \$500,000 qualifies for ITC as shown on Schedule 2200, page 17. The \$15,000 of credit earned is more than Sub 1 can use in the current year. Therefore, the unused credit became available to the other corporations in the combined group that have an Idaho income tax liability.

The Idaho State Tax Commission prepared this brochure to provide general information and guidance. It is not a comprehensive statement of Idaho tax law.

Costs associated with this publication are available from the Idaho State Tax Commission in accordance with Section 60-202, Idaho Code.

## SCHEDULE 1100 COMPANY APPORTIONMENT FACTORS AND TAX LIABILITY

	GROUP RETURN	PARENT CORP	SUB 1	SUB 2	SUB 3
Idaho Property Factor (Sch. 1700)	15.8281%	8.3911%	7.4370%	0.0000%	0.0000%
Idaho Double Weighted Sales Factor (Sch. 1800)	31.6050%	20.9520%	10.6530%	0.0000%	0.0000%
Idaho Payroll Factor (Sch. 1900)	12.9468%	9.7868%	3.1600%	0.0000%	0.0000%
Total Percent	60.3799%	39.1299%	21.2500%	0.0000%	0.0000%
	divide by 4	divide by 4	divide by 4	divide by 4	divide by 4
IDAHO APPORTIONMENT FACTOR	15.0950%	9.7825%	5.3125%	0.0000%	0.0000%
COMBINED UNITARY BUSINESS INCOME SUBJECT TO APPORTIONMENT (Sch. 1200)	2,872,684	2,872,684	2,872,684	2,872,684	2,872,684
IDAHO APPORTIONMENT FACTOR	15.0950%	9.7825%	5.3125%	0.0000%	0.0000%
UNITARY BUSINESS INCOME APPORTIONED TO IDAHO	433,631	281,020	152,611	0	0
Add: Nonbusiness Income(Loss) Allocated to Idaho					
Less: Expenses Allocated to Idaho Nonbusiness Income					
Less: Idaho Net Operating Loss (NOL) Carryforward					
IDAHO TAXABLE INCOME	433,631	281,020	152,611	0	0
Tax Rate		8.0%	8.0%	8.0%	8.0%
Idaho Income Tax (Minimum \$20 if required to file Idaho tax return)	34,711	22,482	12,209	20	0
Permanent Building Fund Tax	30	10	10	10	0
Add: Idaho Investment Tax Credit Recapture					
Less: Payments		0	0	0	0
Less: Credits (see Schedule 2200 for unitary sharing of ITC)	15,000	8,895	6,105	0	
Tax Due	19,741	13,597	6,114	30	0

# SCHEDULE 1200 COMPUTATION OF APPORTIONALBE INCOME

	COMBINED	INTERCOMPANY ELIMINATIONS	TOTAL BEFORE ELIMINATIONS	PARENT CORP	SUB 1	SUB 2	SUB 3
NET INCOME BEFORE STATE ADJUSTMENTS (from Schedule 1300)	2,935,000	(150,000)	3,085,000	1,912,500	660,000	(747,500)	1,260,000
Add:							
State and local taxes measured by income	295,500		295,500	160,000	47,000	500	88,000
Dividends received deduction	24,500	(400,000)	424,500	424,500			
Federal net operating loss deduction			0				
Interest and dividends exempt under I.R.C.	20,000		20,000	20,000			
Total Additions	340,000	(400,000)	740,000	604,500	47,000	500	88,000
Deduct:							
Foreign dividend gross-up							
Idaho municipal interest	0		0				
Tax-exempt interest on U.S. obligations	75,000		75,000	75,000			
Less interest expense offset (Schedule 1500)	(2,684)		(2,684)	(2,684)			
Nonbusiness capital gain income	350,000		350,000	350,000			
Less expense offset	(40,000)		(40,000)	(40,000)			
Nonbusiness dividend income	25,000		25,000	25,000			
Less expense offset	(5,000)		(5,000)	(5,000)			
Total Deductions	402,316	0	402,316	402,316	0	0	0
COMBINED UNITARY BUSINESS INCOME SUBJECT TO APPORTIONMENT	2,872,684	(550,000)	3,422,684	2,114,684	707,000	(747,000)	1,348,000

## SCHEDULE 1300 COMBINED FEDERAL TAXABLE INCOME

	COMBINED	INTERCOMPANY ELIMINATIONS	TOTAL BEFORE ELIMINATIONS	PARENT CORP	SUB 1	SUB 2	SUB 3
Sales	26,000,000	(2,000,000)	28,000,000	10,500,000	6,000,000	3,500,000	8,000,000
Cost of goods sold	16,900,000	(1,850,000)	18,750,000	7,000,000	3,750,000	3,000,000	5,000,000
Gross profit	9,100,000	(150,000)	9,250,000	3,500,000	2,250,000	500,000	3,000,000
Dividends	35,000	(400,000)	435,000	430,000	5,000		
Interest	240,000	(40,000)	280,000	175,000	105,000		
Gross rents	10,000	(45,000)	55,000	55,000			
Gross royalties	0		0				
Capital gain net income	800,000		800,000	800,000			
Net gains and losses	275,000		275,000		275,000		
Other income	0	(300,000)	300,000	300,000			
Total Income	10,460,000	(935,000)	11,395,000	5,260,000	2,635,000	500,000	3,000,000
Compensation of officers	1,080,000		1,080,000	450,000	180,000	150,000	300,000
Salaries and wages	3,365,000		3,365,000	615,000	1,100,000	750,000	900,000
Repairs	15,000		15,000		15,000		
Bad debts	0		0				
Rents	27,500	(45,000)	72,500	7,500	65,000		
Taxes	278,000		278,000	165,000	30,000	33,000	50,000
Interest	375,000	(40,000)	415,000	375,000	15,000		25,000
Contributions			0				
Depreciation	364,500		364,500	205,000	75,000	34,500	50,000
Depletion	0		0				
Advertising	400,000		400,000	400,000			
Pension, profit-sharing, etc., plans	43,000		43,000	43,000			
Employee benefit programs	200,000		200,000	95,000	35,000	30,000	40,000
Other deductions	1,352,500	(300,000)	1,652,500	567,500	460,000	250,000	375,000
Total Deductions	7,500,500	(385,000)	7,885,500	2,923,000	1,975,000	1,247,500	1,740,000
Taxable Income Before NOL's & Sp. Ded.	2,959,500	(550,000)	3,509,500	2,337,000	660,000	(747,500)	1,260,000
Net operating loss deduction							
Special deductions	24,500	(400,000)	424,500	424,500			
<b>FEDERAL TAXABLE INCOME BEFORE STATE ADJUSTMENTS</b>	<b>2,935,000</b>	<b>(150,000)</b>	<b>3,085,000</b>	<b>1,912,500</b>	<b>660,000</b>	<b>(747,500)</b>	<b>1,260,000</b>

## SCHEDULE 1500 INTEREST EXPENSE OFFSET FOR TAX-EXEMPT INTEREST INCOME

	Source	
1a. Interest expense. Total interest expense deducted in determining federal taxable income	(1)	\$375,000
b. Interest expense disallowed under IRC Sections 265 and 291		
c. Interest expense from a pass-through entity		
d. Interest expense of foreign corporations included in the combined report		
e. Subtotal. Add lines a through d.		<u>\$375,000</u>
f. Interest expense of corporations included in the consolidated federal return but not part of the combined report filed with Idaho		
g. Total interest expense. Subtract line f from line e.		<u>\$375,000</u>
2. Total tax-exempt income (interest on qualifying obligations of the United States and interest on qualifying obligations of the State of Idaho, its cities, and political subdivisions)	(2)	75,000
3. Total income (amount reported on the federal return(s), total income from Sch. C Form 5471, and partnership total income and distributive amounts)	(3)	10,480,000
4. Divide line 2 by line 3.		0.0071565
5. Multiply line 1g by line 4. This is the amount of the Interest Expense Offset.		\$2,684

(1) Schedule 1300

(2) Schedule 1200

(3) Schedule 1300 Total Income	\$10,460,000
Schedule 1200 Interest exempt under the IRC	<u>20,000</u>
Total Income	\$10,480,000

## SCHEDULE 1700 PROPERTY FACTOR COMPUTATION

	GROUP RETURN	PARENT CORP	SUB 1	SUB 2	SUB 3
<b>Numerator: Idaho Property</b>					
Beginning Inventory	133,500	68,500	65,000	0	0
Intercompany profits in beginning inventory	(7,000)	(7,000)			
Beginning Real & Tangible Personal Property	715,000	615,000	100,000	0	0
Total Beginning Owned Property - Idaho	841,500	676,500	165,000	0	0
Ending Inventory	157,000	78,000	79,000	0	0
Intercompany profits in ending inventory	(10,000)	(10,000)			
Ending Real & Tangible Personal Property	1,550,000	650,000	900,000	0	0
Total Ending Owned Property - Idaho	1,697,000	718,000	979,000	0	0
Average Beg./Ending Owned Property	1,269,250	697,250	572,000	0	0
Idaho Rent Expense	29,800	4,800	25,000	0	0
Intercompany Rents	(15,000)		(15,000)		
Net Idaho Rent Expense Capitalized X 8	118,400	38,400	80,000	0	0
<b>Total Owned &amp; Rented Property - Idaho (Average Property +Capitalized Rents)</b>	1,387,650	735,650	652,000	0	0
<b>Denominator: Everywhere Property</b>					
Beginning Inventory	2,870,000	2,200,000	250,000	235,000	185,000
Intercompany profits in beginning inventory	(100,000)	(100,000)			
Beginning Real & Tangible Personal Property	5,192,000	2,567,000	700,000	475,000	1,450,000
Total Beginning Owned Property - Everywhere	7,962,000	4,667,000	950,000	710,000	1,635,000
Ending Inventory	1,672,000	1,035,000	270,000	217,000	150,000
Intercompany profits in ending inventory	(150,000)	(150,000)			
Ending Real & Tangible Personal Property	7,610,000	2,575,000	2,500,000	435,000	2,100,000
Total Ending Owned Property - Everywhere	9,132,000	3,460,000	2,770,000	652,000	2,250,000
Average Beg./Ending Owned Property	8,547,000	4,063,500	1,860,000	681,000	1,942,500
Everywhere Rent Expense	72,500	7,500	65,000		
Intercompany Rents	(45,000)		(45,000)		
Net Everywhere Rent Expense Capitalized X 8	220,000	60,000	160,000		
<b>Total Owned &amp; Rented Property - Everywhere (Average Property + Capitalized Rents)</b>	8,767,000	4,123,500	2,020,000	681,000	1,942,500
Total Owned & Rented Property - Idaho	1,387,650	735,650	652,000	0	0
Total Owned & Rented Property - Everywhere	8,767,000	8,767,000	8,767,000	8,767,000	8,767,000
<b>Idaho Property Factor</b>	15.8281%	8.3911%	7.4370%	0.0000%	0.0000%



## SCHEDULE 1800 SALES FACTOR COMPUTATION

	GROUP RETURN	PARENT CORP	SUB 1	SUB 2	SUB 3
<b>Idaho Sales</b>					
Sales delivered or shipped to Idaho purchasers:					
From outside Idaho	1,200,000	700,000	500,000	0	0
From within Idaho	3,000,000	2,000,000	1,000,000	0	0
Sales shipped from within Idaho to:					
The United States Government	50,000	50,000			
Purchasers in a state where the corporation making the sales is not taxable due to Public Law 86-272	200,000	200,000			
Other gross receipts	30,000	25,000 (a)	5,000 (b)		
Less intercompany receipts	(15,000)	(15,000) (c)			
<b>Total Sales - Idaho</b>	<b>4,465,000</b>	<b>2,960,000</b>	<b>1,505,000</b>	<b>0</b>	<b>0</b>
<b>Everywhere Sales</b>					
Gross receipts, less returns and allowances	28,000,000	10,500,000	6,000,000	3,500,000	8,000,000
Other gross receipts (rents, royalties, etc)	3,040,000	1,430,000 (d)	1,610,000 (e)	0	0
Less intercompany receipts	(2,785,000)	(785,000) (f)	(200,000) (g)	(1,400,000) (g)	(400,000) (g)
<b>Total Sales - Everywhere</b>	<b>28,255,000</b>	<b>11,145,000</b>	<b>7,410,000</b>	<b>2,100,000</b>	<b>7,600,000</b>
Total Sales - Idaho	4,465,000	2,960,000	1,505,000	0	0
Total Sales - Everywhere	28,255,000	28,255,000	28,255,000	28,255,000	28,255,000
Idaho Sales Factor multiplier	15.8025% x 2	10.4760% x 2	5.3265% x 2	0.0000% x 2	0.0000% x 2
<b>Idaho Double Weighted Sales Factor</b>	<b>31.6050%</b>	<b>20.9520%</b>	<b>10.6530%</b>	<b>0.0000%</b>	<b>0.0000%</b>

## Notes for Schedule 1800:

(a) \$25,000 consists of \$10,000 of interest income received on an installment sale to an Idaho customer, plus \$15,000 received from Sub 1 on warehouse rental in Idaho.

(b) \$5,000 of interest income received by Sub 1 from Idaho customers on revolving lines of credit to Idaho customers.

(c) \$15,000 of rents received by Parent Corp. from Sub 1 on warehouse space in Idaho is eliminated as an intercompany receipt.

(d) Dividends	430,000	(f) Dividends	400,000
Interest	175,000	Interest	40,000
Interest and dividends exempt under the IRC	20,000	Rents	45,000
Gross rents	55,000	Other income	300,000
Net gain on securities in cash management portfolio (\$800,000 - \$350,000 nonbusiness gain)	450,000	Parent Corp., Intercompany receipts	785,000
Other income	300,000		
Parent Corp., Other gross receipts	1,430,000		
(e) Dividends	5,000	(g) Sub 1, intercompany sales	200,000
Interest	105,000	Sub 2, intercompany sales	1,400,000
Sales price of mfg. plant resulting in \$350,000 gain	1,500,000	Sub 3, intercompany sales	400,000
Sub 1, Other gross receipts	1,610,000	Agrees with line 1 on Schedule 1300	2,000,000

SCHEDULE 1900 PAYROLL FACTOR COMPUTATION

PAYROLL FACTOR	GROUP RETURN	PARENT CORP	SUB 1	SUB 2	SUB 3
Idaho Payroll	898,900	679,500	219,400	0	0
Everywhere Payroll	6,943,000	2,150,000	1,743,000	1,150,000	1,900,000
Total Payroll - Idaho	898,900	679,500	219,400	0	0
Total Payroll - Everywhere	6,943,000	6,943,000	6,943,000	6,943,000	6,943,000
Idaho Payroll Factor	12.9468%	9.7868%	3.1600%	0.0000%	0.0000%

## SCHEDULE 2200 UNITARY SHARING OF IDAHO INVESTMENT TAX CREDIT

Idaho Investment Tax Credit	GROUP RETURN	PARENT CORP	SUB 1	SUB 2	SUB 3
Qualifying Property		0	500,000	0	0
ITC Rate		3.0%	3.0%	3.0%	3.0%
Credit Earned		0	15,000	0	0
ITC Applied (limited to 50% of income tax liability)	(6,105)		(6,105)		
ITC Available for Carryover or Sharing			8,895		
ITC Shared	(8,895)	(8,895)	(8,895)	0	0
ITC Carryover			0		
Total Applied On Group Return	(15,000)				